BRIEF IN SUPPORT OF PETITIONER.

OPINIONS BELOW.

The opinion of The Tax Court (R. 95-110) was promulgated September 22, 1942, and is reported at 47 B. T. A. 715. The opinion of the Circuit Court of Appeals (R. 147 to 155) was rendered March 31, 1944, and is reported at 142 F. (2d) 216.

STATEMENT OF FACTS.

The pertinent facts are set forth in the foregoing petition at pages 2 to 4 hereof.

STATUTES INVOLVED.

The relevant provisions of the Revenue Act of 1936 are set forth in the petition at pages 4 and 5 thereof.

SPECIFICATION OF ERRORS.

The errors which petitioner will urge, if the writ of certiorari be granted, are that the Circuit Court erred:

1. In disregarding the express provisions of the plan of reorganization of Nashville Gas and Heating Company as confirmed by the reorganization court and in holding that petitioner exchanged its old stock and unsecured indebtedness for new stock of the reorganized company.

2. In failing to hold that petitioner received nothing for its common and preferred stock of Nashville Gas and Heating Company upon reorganization, that such stock became worthless in 1937 and that petitioner was entitled to deduct its investment in such stock as a loss.

3. In failing to hold that petitioner received nothing for its unsecured indebtedness of Nashville Gas and Heating Company upon reorganization and that petitioner was entitled to deduct the amount thereof in its income tax return for 1937, having ascertained it to be worthless and having charged it off in that year.

ARGUMENT.

I. Introductory.

The question presented by this case is of paramount importance to many holders of securities of companies which have reorganized under Section 77B of the Bankruptcy Act or under the provisions of other Federal or local laws giving rise to "reorganizations" as defined by Section 112(g) of the Revenue Act of 1936 and the corresponding provisions of prior and subsequent Revenue Acts and of the Internal Revenue Code. It frequently happens that in such proceedings, as in the instant case, junior securities are denied participation in the reorganized company. Not infrequently the holders of such junior securities are also the holders of senior securities which are permitted to share in the reorganization. Those who own only such junior securities cannot be said to have exchanged anything and they are therefore entitled to deduct their investment in such securities in the year of worthlessness. At the opposite end are those who own only senior securities which are entitled to participate in the plan. As to them, assuming a "reorganization" within the definition of Section 112(g) of the Internal Revenue Code and the corresponding provisions of prior Revenue Acts, there is unquestionably an exchange of old securities for new and any gain or loss is postponed until disposition is made of the new securities. Between these two extremes are those who own both junior securities,

not entitled to participation, and senior securities, entitled to participation. The Court below has said that such holders must treat their holdings as one package in exchange for which they receive new securities, even though such new securities are available to the holder only because of his holding of senior securities.

II. Petitioner Did Not Exchange Its Stock and Unsecured Indebtedness.

Although petitioner has not contested the finding that the reorganization of Nashville Gas and Heating Company was a "recapitalization" and hence a "reorganization" under Section 112(g) of the Revenue Act of 1936, both courts below devoted considerable space in their opinions to this point as though it necessarily followed that no loss could be allowed where there was a reorganization. In order for loss to be denied under Section 112(b)(3) of the Revenue Act of 1936, it is essential that there be an exchange.

This Court in *Fairbanks* v. *United States*, 306 U. S. 436, involving the Revenue Acts of 1926 and 1928, stated:

> "Payment and discharge of a bond is neither a sale nor exchange within the commonly accepted meaning of the words",

thereby setting up a requirement that "exchange" as used in the revenue laws must be given its everyday meaning.

Again in *Helvering* v. *William Flaccus Oak Leather Co.*, 313 U. S. 247, holding proceeds of fire insurance not to have been received in an exchange, this Court said:

> "'exchange' * * * implies reciprocal transfers of capital assets, * * *."

Article 112(a)-1 of respondent's Regulations 94 (under the Revenue Act of 1936) provides:

> "* * * To constitute an exchange within the meaning of section 112(b)(1) to (5), inclusive, the transaction must be a reciprocal transfer of property, as distinguished from a transfer of property for a money consideration only. * * *"*

Both the Circuit Court and The Tax Court have held that petitioner "exchanged" its stock and unsecured indebtedness in the reorganization of Nashville Gas and Heating Company, although both the plan of reorganization and the decree of the reorganization court confirming such plan definitely provided that nothing should be received by petitioner for its stock or unsecured indebtedness. In disregarding the decree of the reorganization court and holding that there was such exchange in the instant case the decisions of the lower courts are in conflict with the decision of this Court in *Case* v. *Los Angeles Lumber Co.*, 308 U. S. 106, wherein it was held that as a matter of law a plan of reorganization under Section 77B of the Bankruptcy Act could not be confirmed if it provided for distribution of securities of the reorganized company to holders of securities of the old company having no equity. Under this decision the reorganization court would not have provided for distribution of new securities to petitioner with respect to its stock and unsecured indebtedness. Nevertheless, both courts below held that this was what was done "in effect".

The error of the decisions below is most clearly apparent in the case of the common stock owned by petitioner. Although a large majority of this stock was owned by petitioner there was a minority owned by outsiders. It cannot be said that a plan of reorganization would have been "fair and equitable" as required by Section 77B if it had provided that petitioner would re-

* This provision is the same as in Regulations 111 (1943) Sec. 19.112 (a)-1; Regulations 103 (1940) Sec. 19.112(a)-1; Regulations 101 (1938) Art. 112(a)-1; Regulations 84 (1934) Art. 112(a)-1.

ceive something for its majority interest but that the minority would receive nothing.*

III. The Decree of the Reorganization Court Was Binding Upon the Courts Below.

The reorganization proceeding of Nashville Gas and Heating Company was an *in rem* proceeding. *Local Loan Co.* v. *Hunt*, 292 U. S. 234. The decree of the reorganization court was a decree *in rem* and provided that the rights of all stockholders were terminated, that the debt was cancelled and that nothing should be received in exchange for the stock and debt, title to which was divested (R. 85, 86).

A judgment *in rem* of a competent court is conclusive upon all persons as to interests in the thing. Restatement of the Law of Judgments, Section 73(1). The rule is elaborated in Comment a to Section 73, as follows:

> "*Effect of judgment on interests in a thing.* Where in a proceeding *in rem* a competent court has after proper notice determined interests in property over which the court has jurisdiction, the determination of those interests is binding on all persons in the world. (See §2.) The judgment is not subject to collateral attack by anyone, unless the judgment was void because the court did not have jurisdiction over the thing or was not competent to render the judgment or there was a failure to give proper notice and

*The Circuit Court determined that after the reorganization the new common stock had a book value which included approximately $800,000 ascribable to the old preferred and common (R. 151). Assuming *arguendo* that the Court's theory is correct it should, at least, have held the common stock to be worthless because the preferred stock which had preference in distribution had a par value of $800,000 and dividends accumulated thereon amounted to $408,000 (R. 39). However, this mathematical determination based on book values must give way to the reorganization court's adjudication that the plan, which provided nothing for old preferred and common stockholders, did not discriminate against any class (R. 79).

opportunity to be heard. (See §32.) As far as interests in the thing are concerned, the judgment is binding not only on persons who were subject to the jurisdiction of the court which rendered the judgment, but also on persons not personally subject to the jurisdiction of the court."

Applied to the instant case the foregoing principles are not mere abstract legal concepts but constitute a sound basis for decision. The District Court of the United States for the Middle District of Tennessee, not The Tax Court nor the Circuit Court of Appeals for the Third Circuit, had jurisdiction of the reorganization proceedings. In *Case* v. *Los Angeles Lumber Co.*, 308 U. S. 106, this Court stated at pages 114 and 115:

"* * * Accordingly the fact that the vast majority of the security holders have approved the plan is not the test of whether the plan is a fair and equitable one. This is in line with the decision of this Court in *Taylor* v. *Standard Gas & Electric Co.*, 306 U. S. 307, which reversed an order approving a plan of reorganization under §77B, in spite of the fact that the requisite percentage of the various classes of security holders had approved it, on the ground that preferred stock of the debtor corporation was inequitably treated under the plan. The contrary conclusion in such cases would make the judicial determination on the issue of fairness a mere formality and would effectively destroy the function and the duty imposed by the Congress on the district courts under §77B. That function and duty are no less here than they are in equity receivership reorganizations, where this Court said, 'Every important determination by the court in receivership proceedings calls for an informed, independent judgment.' *National Surety Co.* v. *Coriell*, 289 U. S. 426, 436."

The decree of the reorganization court cannot be considered, as it was by the courts below, as a mere formality confirming the whim of the security holders. The court's determination that the plan was "fair and equitable" must be recognized to have been based on an informed, independent judgment after a study of all the facts of the reorganization proceeding. As such the decree is not open to collateral attack.

IV. Conclusion.

This Court should grant the Writ of Certiorari to review the decision of the Court below on all issues herein.

Respectfully submitted,

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